Essex Powerlines Corporation

Festival Hydro Inc.

Haldimand County Hydro Inc.

Innisfil Hydro Distribution Systems Ltd.

Lakefront Utilities Inc.

Midland Power Utility Corporation

Parry Sound Power Corporation

Welland Hydro Electric System Corp.

Westario Power Inc.

Whitby Hydro Electric Corp.

ONTARIO ENERGY BOARD

INFORMAL CONSULTATION

PROCESS FOR ESTABLISHING 2006 ELECTRICITY DISTRIBUTION RATES

July 16, 2004

Prepared With The Assistance Of:

RDII UTILITY CONSULTING & TECHNOLOGIES INC.

Executive Summary

- The following submission has been prepared by a coalition of 10 LDC's including Essex Powerlines Corporation, Festival Hydro Inc., Haldimand County, Innisfil Hydro Distribution Systems Ltd., Lakefront Utilities Inc., Midland Power Utility Corporation, Parry Sound Power Corporation, Welland Hydro Electric System, Westario Power Inc., and Whitby Hydro Electric Corp.

- The coalition put forward its initial views through a presentation and written submission to the July 6-7 2004 informal process in Toronto.

- In this final submission to the informal process the coalition has identified broader strategic themes (process and implementation) and has provided summarized comments on the 33 initial issues identified by the Board and the additional issues identified by participants during the 2 days of meetings.

- The coalition is concerned that resolution of the expanded issues list (now greater than 50) within the anticipated timelines is ambitious and perhaps unachievable given the scope and complexity of the issues. The ability of all participants in the process to mutually agree in advance on issues may be an overly optimistic goal given the perspective that other interveners brought to the 2 day informal process. A low priority issue for LDC's may be a high priority for other interveners. The establishment of industry working groups to deal with issues can be a long cumbersome process.

- The coalition strongly believes ***the Board*** must prioritize the issues list and give priority to issues with the highest order of magnitude contributing to an improved rate setting process. This would require the Board to develop a prioritization methodology in addition to ongoing dialogue with stakeholders. The result would be the creation of a clearly defined regulatory timetable over the next 3 to 4 years. The Board should take a more proactive leadership role in rewriting the Rate Handbook and regulating the industry.

- The coalition members have completed a preliminary issues prioritization exercise to provide the Board with their views on the relative importance of the issues identified. (see Appendix A). Twelve high priority issues have been identified.

- The coalition supports in principle the establishment and application of "meaningful" comparators. LDCs should aspire to efficiency measures that protect customer interests and meet shareholder expectations.

- The coalition believes certain issues identified on the issues list should not proceed in advance of cost allocation, as cost allocation is central to determining an outcome on the issue (un-metered scattered load, time-of-use rates, fixed/variable etc.)

- The coalition recommends the Board pursue a regulatory environment similar to the CRTC which employs a lighter handed regulatory regime on smaller organizations than larger organizations. We encourage the Board to communicate with their peers at the CRTC to better understand how a tiered regulatory framework could work in the regulation of Ontario's LDC's. A one size fits all regulatory framework may not be the best form of regulation in Ontario given the number of LDC's and size variations.

- The potential significant increase in regulatory complexity has an impact on both LDC's and the Board to administer the process.

- The coalition is concerned about the disconnect between Board staff's ability to advise and the Board's ability to decide. Frustration and uncertainty are perpetuated when a lack of guidance or differing interpretations can be obtained from Board staff with no sense of how the Board will actually decide the issues.

- The coalition strongly believes the Board must establish clearer and more prescriptive accounting and code guidelines. The determination and adherence to specific accounting treatments and cost allocation should be a priority. Consistency in financial reporting and information is a must. Comparators without consistency of data are not meaningful.

- Guidelines/comparators should not be applied immediately in the rate setting process. They must be clearly defined and LDCs should be afforded reasonable notice and timeframes to make appropriate adjustments to their operations. Regulation should not create a potentially punitive financial situation for LDC's.

- The coalition believes that certain issues (capital projects, employee compensation and staffing, advertising, entertainment……research and development) without further clarification, are approaching on intrusive regulation. We believe the risk related to smaller size utilities is minimal and mechanisms are available to deal with exceptions to the rules. There are other alternatives to using a "no stones unturned" approach to regulation. (eg. evaluate distribution system capital expenditures based on adherence to established reliability performance measures).

- The coalition is concerned about the apparent mirroring of the electricity regulatory environment after the gas environment in Ontario. There are fundamental differences that must be recognized in the design of the Ontario electricity regulatory framework.

- The Board should clarify any areas of overlap and subsequent impacts resulting from the oral hearings on regulatory assets.

Coalition Summary Comments

OEB – Potential Issues For Generic Methodology Review

Comparators and Cohorts:

1. Comparators & Cohorts

- Comparators and cohorts are a reasonable regulatory objective to set standards and assess productivity and effectiveness

- Currently there is no common base for comparison. LDC measures are all over the map due to a variety of factors:

  Utility customer size
  Customer mix
  Customer density
  Asset vintages
  Etc.

- Reliability SQI's do not have a defined standard so LDC's are unsure if they are over or under investing

- Some comparators will require completion of the cost allocation study (eg. cost/customer class) to be meaningful

- Broad based measures such as cost/customer could be used as an interim measure. Administrative costs and customer billing/collecting costs should be relatively stable

- Comparators should be fewer versus more (keep it simple). The coalition recommends lighter handed regulation for smaller utilities than for larger utilities similar to existing CRTC approach to regulatory oversight

- Any comparators affecting distribution revenue should be specifically defined and utilities given sufficient time to amend operations in order to avoid punitive financial impacts.

- Currently the consistency of financial information which will be used in establishing comparators suffers from a lack of consistency in interpreting and applying accounting guidelines and codes

Revenue Requirement - General Issues

2. Test Year For Establishing Rate Base / Revenue Requirement

- Coalition supports using latest historical year with adjustments for known material changes (removal of non recurring items and addition of new items)
- Inflationary increase could be addressed through application of the IPI
- Future true-ups for material differences from revenue requirement used to determine rates
- Benefit in aligning fiscal year with rate year
- Example
    - rate application submitted in June 2005 for 2006 rate year (January 1 to December 31) based on 2004 actuals with adjustments for known differences
    - material differences between rate setting revenue requirement and actual revenue requirement to be adjusted in setting the next year's rates in June 2006
    - in addition there is merit to consider staggering of rate submissions to the Board – less onerous deadlines on LDC's and matches the Board's ability to deal with the volume of applications

3. Load Forecast

- Coalition favours a historical approach
- Any revenue impacts from implementation of DSM programs would need to be incorporated into rate setting

4. Test Year Adjustments

- See response to 2. re: true-ups to historical based rate setting
- Adjustments or true-ups should be subject to the same 4 criteria used to assess extraordinary and transition costs

5. Weather Normalization

- Weather risk can be mitigated through a combination of rate design (larger fixed portion) and future revenue requirement true-ups

6. Return on Equity for 2006 Electricity Distribution Rates

- Coalition favours multi-year approach vs. annual approach
- More stability in customer class rates and shareholder expectations
- Uncertainty exists regarding impact on risk as a result of resolution of the issues under consideration by the Board – risk affects ROE

7. Debt/Equity Structure

- Favour a consistent deemed approach for all utilities
- No need to use utility specific D/E ratios if deemed ratios truly reflect the capital market's view of utility balance sheets as there would only be slight differences between deemed and actual
- Customers should not be burdened with higher rates if utility strategic goal is to increase equity financing

8. Debt Rate / Cost of Capital

- Utilities have different debt management practices with differing maturities and rates, portions of which are locked-in
- Favour a cost pass through approach using actual weighted average cost of debt subject to a cap to be determined by the regulator using a multi-year view similar to the cost of debt setting for PBR1

9. Depreciation Rates

- In the coalition's view a process to review depreciation rates should not be considered for 2006 rates but follow the other more critical regulatory processes:

    - Resolving all the issues (including new issues) to complete prudency review of revenue requirement
    - Cost Allocation
    - DSM

10. Transfer Pricing and Shared Corporate Services

- Coalition believes that more specific guidelines/examples should be developed by the Regulator to provide direction to utilities with respect to expectations and provide consistency of approach by utilities

11. Low Voltage and Wheeling Costs

- Hydro One LV charges to LDC's should not be a distribution revenue issue
  - Set up as another RSVA

- LDC to LDC wheeling charges are an insignificant issue for coalition members – defer as part of the cost allocation study

12. 2006 Taxes / PILS

- LDC's make installment tax payments based on previous year actuals
- Recommend PILS included in rates be based on last actual tax return
- Future true-ups to actual to reflect original market design intent of cost pass through to end use customers

Distribution Rate Base Issues

13. Definition of Distribution Rate Base

- No comment from coalition

14. Rate Base Measurement Date

- See response to 2.

15. Working Capital Component of Rate Base

- Support common WCA formula to ensure efficient working capital management and avoid returns on "excess" working capital
- 15 % regulated level should be examined for appropriateness once stability is achieved in the deregulated market

16. Capitalizing Expenses

- Inconsistent accounting practices amongst utilities contribute to different financial results re: profit and loss and total capital expenditures
- Recommend more prescriptive accounting guidelines from the Board to ensure consistency of financial results

17. Capital Projects

- Majority of capital projects can be assessed by using a light handed regulatory approach through review of system reliability standards (to be determined by the Board)
- Significant concern over regulatory review of capital projects:
    - Increased regulatory complexity and administrative effort
    - No regulatory criteria currently exists for review
    - Pre-approval or post-approval risk re: inclusion in rate base
    - Exclude demand driven capital due to obligation to serve
    - Potential delays to builders/developers/customers due to review process

18. Contributed Capital

- External audit review of LDC financial statements provides independent validation of appropriate contributed capital accounting
- Depreciation on full asset value should be allowed in rates to provide funding for LDC responsibility to replace the asset at the end of its useful life

19. No Cost Capital

- No comment from coalition until more specific details are provided to define no cost capital that would or would not be included in rate base

20. Rate Setting Treatment of Capital Gains

- 100% of any gains related to the sale of assets or shares should accrue to shareholders
- Not an issue identified in initial market design or considered when municipalities decided to retain their LDC's

21. Distribution Wires Only Expenses

- No comment from coalition

22. Post Retirement Benefits and Pensions

- Coalition believes that regulatory treatment for rate setting purposes should mirror GAAP accounting requirements

23. Site Restoration and Removal Costs

- No comment from coalition

24. Insurance Expense

- Coalition members purchase insurance from MEARIE reciprocal and competitive insurance markets – no need to assess appropriateness of insurance expenses
- Board may wish to assess the level of coverages employed to assess level of protection to financial soundness of LDC's

25. Bad Debt Expense

- Coalition recommends establishing a tolerance band to establish acceptable levels of bad debt expense (eg. X to Y % of total billed revenue)
- Must be an "extraordinary" provision to accommodate unusual circumstances – eg. bankruptcy of a large GS>50kw customer with no customer deposit
- Alternative approach would be 100% cost recovery if LDC in compliance with codes and prudently managing risk

26. Employee Compensation and Staffing
27. IT Costs
28. Advertising, Entertainment, Charitable/Political Contributions, Employee Dues, Research & Development

- Coalition concerned about the level of regulatory intrusiveness contemplated in these 3 issues
- LDC's are OBCA entities with oversight by Boards of Directors having fiduciary responsibilities to appropriately manage the businesses
- Smaller LDC's offer low risk
- LDC's already provide a significant amount of detailed data through regulatory filings that would allow the Board to deal with the exceptions and further investigate if they were concerned
- Opportunity to further refine USOA to collect specific costs for review
- LDC's must compete for human resources in the marketplace – acts as a check and balance

2006 Rate Design Matters

TOU Distribution Rates

- In the Coalition's view the process to determine TOU distribution rates should not be considered for 2006 rates but follow the other critical regulatory processes:
  - Resolving all the issues (including new issues) to complete revenue requirement prudency review
  - Cost Allocation
  - DSM

29. Specific Service Charges

- Support standardization of some Miscellaneous Charges – eg. Change of Occupancy
- Other charges must reflect the differing underlying cost structures of the individual utilities – eg. disconnection after hours
- Consideration must be given to any revenue differentials similar to the late payment charge adjustment to distribution revenue

30. Unmetered Scattered Load

- Should be resolved as part of cost allocation which will also deal with customer classifications

31. Time of Use Rates

- Again the coalition supports deferral of this issue to the cost allocation study process as any integration of existing customer classes would be premature and somewhat arbitrary

32. Fixed/Variable

- Support retention of existing individual utility rates until cost allocation completed
- Movement from existing rates would be arbitrary and not supported by any underlying cost causation analysis
- Changing fixed (and corresponding variable rates to maintain revenue neutrality) rates would result in revenue stability impacts to all utilities both positively and negatively

33. 2006 Rate Mitigation

- Rate mitigation should wait until cost allocation study completed and “true” fixed/variable rates determined based on cost causation
- Customer impacts should focus on distribution revenue requirement changes only
- Any mitigation of distribution rates should be based on distribution rate changes alone and not include pass through commodity and non competitive charge changes. LDC revenue stability should not be impacted by non distribution events

Coalition Summary Comments

Additional Issues Identified During July 6-7 2004 Informal Process

Transformation Capital Contributions

- Any capital contribution expenditures required by LDC to provide service to their customers should be included in rate base

Shared Assets

- The LDC portion of shared assets (amount paid for) used to provide service to their customers should be included in rate base

TS Ownership

- Regardless of ownership LDC's should be allowed to recover all their associated costs, either through distribution rates (operating costs + return on invested capital) or pass through of third party costs

Wholesale Meters

- Incremental costs resulting from wholesale metering requirements should be included in rate base

Standby Charges

- Existing distribution rates applied to agreed upon standby consumption levels (customer and LDC) could serve as proxy standby rates
- Further review of this issue should be pursued under cost allocation

Ancillary Revenue Treatment

- No comment from coalition

Earnings Sharing

- Mechanisms for earnings sharing should be examined as part of PBR2 – not part of prudency of revenue requirement process underway - this is a regulatory framework issue
- Must be sufficient incentives to LDC's to drive efficiency improvements

DSM Revenue Erosion

- Must be assessed and true-ups provided to LDC's if material
- Fixed/variable rate design following cost allocation could mitigate (eg. High fixed cost component)

SSS Administration Costs and Charges

- Analysis and evidence to date shows significant material cost under recovery that should be addressed as part of 2006 Rate Setting process (either through adjustment of the SSS rates or distribution revenue requirement rebasing)

Defer Rate Design Issues To Cost Allocation

- Fully support this concept and have identified in Appendix A which specific issues should be deferred to cost allocation

Dual Regulatory Regime

- The coalition recommends the Board pursue a regulatory environment similar to the CRTC which employs a lighter handed regulatory regime on smaller organizations than larger organizations. We encourage the Board to communicate with their peers at the CRTC to better understand how a tiered regulatory framework could work in the regulation of Ontario's LDC's. A one size fits all regulatory framework may not be the best form of regulation in Ontario given the number of LDC's and size variations.

Impact of TSC Changes

- No comment from coalition

Bill 100 Implementation

- One time re-regulation costs incurred by LDC's should be subject to similar recovery treatment to original market Transition costs

Rate Harmonization

- No comment from coalition

DSM Assets In Rate Base

- DSM investments should be included in rate base in 2006
- Difficulty rests with OEB approval process re: last 1/3 MARR and rate base eligible DSM expenditures

Distribution Efficiency (dis)incentives

- 3 perspectives on this issue:
    - Establishment and application of Productivity Factor adjustment
    - Determination of earnings sharing mechanisms
    - Application of comparators

"Desired End State" May Impact 2006 EDR

- Acknowledge that it would be nice to know where we ultimately end-up but not possible within tight timelines

Rate Year Anniversary Date

- See response to Board Identified Issue # 2

Update APH / More Prescriptive Accounting Guidelines

- The coalition strongly believes the Board must establish clearer and more prescriptive accounting and code guidelines. The determination and adherence to specific accounting treatments and cost allocation should be a priority. Consistency in financial reporting and information is a must. Comparators without consistency of data are not meaningful.

Cost Allocation in 2006

- Previous rate applications have used distribution revenue and energy to allocate costs
- Current Regulatory Asset Proceeding is considering cost allocation
- Coalition prepared to accept Board direction re: cost allocation of the 2006 revised revenue requirement in advance of definitive cost allocation process to be used for future rate setting purposes

1999 Financial Loss Treatment

- Support 1999 loss recovery to level the playing field for all LDC's in the Province subject to Board determined review criteria (eg. Losses due to one time non recurring expense should not be eligible for recovery but a loss due to rate reductions to reduce working capital levels at the direction of the former regulator that are not sustainable should be allowed)